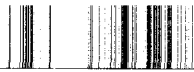


**REDUCING THE DEFICIT:
SPENDING AND REVENUE OPTIONS**

The Congress of the United States
Congressional Budget Office

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402





NOTES

Unless otherwise indicated, all years referred to in this report are calendar years.

Dashes in tables in this report indicate amounts less than \$2.5 million.

Details in the text and tables of this report may not add to totals because of rounding.

The Balanced Budget and Emergency Deficit Control Act of 1985 is also referred to in this volume more briefly as the Balanced Budget Act.

PREFACE

The Congressional Budget Office (CBO) is required by section 202(f) of the Congressional Budget Act of 1974 to submit an annual report on budgetary options to the Senate and House Committees on the Budget. This year, the report is in two parts, with this report constituting Part II. Part I is entitled *The Economic and Budget Outlook: Fiscal Years 1987-1991*.

This report provides background information for each major spending area of the budget and for revenues, and analyzes various specific options that would reduce the deficit. The inclusion of an option in the report, or the omission of one, does not imply a recommendation by CBO. In accordance with CBO's mandate to provide objective and impartial analysis, this report contains no recommendations.

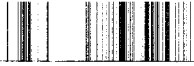
All divisions of the Congressional Budget Office contributed to this report, which was prepared under the supervision of Robert W. Hartman. Martin D. Levine was responsible for Section I. John D. Mayer, Stephen H. Long, James G. Vertrees, Elliot Schwartz, Earl A. Armbrust, and Eric Toder were responsible for coordinating the specific deficit reduction options in Section II of this volume. Budget authority and outlay estimates were coordinated by Charles E. Seagrave, Robert A. Sunshine, Michael A. Miller, and William P. Myers. Revenue and outlay projections were prepared under the supervision of Rosemary D. Marcuss and Paul N. Van de Water, respectively. The Joint Committee on Taxation provided estimates of revenue options.

Paul L. Houts supervised the editing and production of the report, assisted by Nancy H. Brooks. Major portions were edited by Patricia H. Johnston, Francis S. Pierce, Sherry Snyder, and Johanna Zacharias. Others who assisted in preparing the manuscript for publication were Mary Braxton, Jill Bury, Gwen Coleman, Antoinette Foxx, Paula Gatens, Shirley Hornbuckle, Betty Jarrells, Patricia Joy, Rebecca Kees, Norma Leake, Angela McCullough, Ronald Moore, and Kathryn Quattrone.

Rudolph G. Penner
Director

March 1986





CONTENTS

SECTION I	REDUCING THE DEFICIT	1
CHAPTER I	INTRODUCTION	3
	The Outlook for the Federal Deficit	3
	The Context of Budget Decisions for 1987	8
CHAPTER II	ALTERNATIVE APPROACHES TO MEETING THE DEFICIT TARGETS	13
	The Starting Point	13
	Alternative Deficit Reduction Approaches	18
SECTION II	SPENDING AND REVENUE OPTIONS	29
	How to Use This Volume	31
	National Defense	33
	DEF-01 Amend the Administration's Airlift Plan	34
	DEF-02 Reduce Construction of New Submarines and Extend the Service Life of Existing Ships	36
	DEF-03 Cancel or Reduce Procurement of the F-15	37
	DEF-04 Cancel the Army Helicopter Improvement Program	38
	DEF-05 Cancel Procurement of Aquila Remotely Piloted Vehicle	39
	DEF-06 Cancel V-22 Aircraft Development	41
	DEF-07 Cancel E-6 Aircraft Procurement	43
	DEF-08 Cancel M9ACE Armored Combat Earthmover	44



DEF-09	Cancel the Advanced Medium-Range, Air-to-Air Missile	46
DEF-10	Delay Advanced Tactical Fighter (ATF) Development	48
DEF-11	Delay Procurement of Trident II Missile	49
DEF-12	Cancel the Bradley Fighting Vehicle	50
DEF-13	Reduce MX Test Missiles	52
DEF-14	Alter Funding for Supporting Procurement	54
DEF-15	Alter Research and Development Funding	56
DEF-16	Slow Growth in the Strategic Defense Initiative	58
DEF-17	Alter Funding for Military Construction	59
DEF-18	Slow Increases in the Tactical Air Force	60
DEF-19	Place Three Carrier Battle Groups in Reserve	62
DEF-20	Retire Some G-Model B-52 Strategic Bombers Early	64
DEF-21	Alter Operation and Maintenance Funding	66
DEF-22	Restore Former Enlisted-Officer Ratios	68
DEF-23	Impose Fees for Military Outpatient Care	70
DEF-24	Selectively Raise Military Pay	71
DEF-25	Implement Proposed Changes in Military Retirement	73
Entitlements and Other		
	Mandatory Spending	77
ENT-01	Tax Employer-Paid Health Insurance	78
ENT-02	Reduce Medicare's Payments for Indirect Medical Education Costs	81

ENT-03	Reduce Reimbursements for Capital Expenditures Under Medicare	83
ENT-04	Reduce Medicare's Payments to Hospitals for Direct Medical Education Expenses	87
ENT-05	Increase the Hospital Insurance Payroll Tax	89
ENT-06	Adopt a Fee Schedule for Reimbursing Physicians Under Medicare	90
ENT-07	Increase Medicare's Premium for Physicians' Services	93
ENT-08	Use the Tax System to Impose a Supplementary Income-Related Premium for Physicians' Services	95
ENT-09	Tax a Portion of Medicare Benefits	97
ENT-10	Increase Medicare's Deductible for Physician Services	99
ENT-11	Limit Payments for Long- Term Care Services	100
ENT-12	Restrict Cost-of-Living Adjustments in Non- Means-Tested Benefit Programs	102
ENT-13	Limit the Increase in the Social Security "Bend Points"	106
ENT-14	Reduce the Replacement Rate Within Each Bracket of the Social Security Benefit Formula	108
ENT-15	Lengthen the Social Security Benefit Computation Period by Three Years	110



ENT-16	Eliminate Social Security Benefits for Children of Retirees Aged 62-64	111
ENT-17	Cover All Newly Hired State and Local Government Workers Under Social Security and Medicare	112
ENT-18	Eliminate Veterans' Compensation Payments for Those With Low- Rated Disabilities	114
ENT-19	Require a Two-Week Waiting Period for Unemployment Insurance Benefits	116
ENT-20	Index the Unemployment Insurance Taxable Wage Base	118
ENT-21	Reduce Guaranteed Student Loan Subsidies	120
ENT-22	Reduce the Subsidy for Nonpoor Children in Child Nutrition Programs	123
ENT-23	Reduce and Retarget Aid for Dependent Care	125
ENT-24	Terminate General Revenue Sharing	127
Agricultural Price Supports		129
AGR-01	Reduce Deficiency Payments by Lowering Target Prices	130
AGR-02	Eliminate Deficiency Payments on Excess Acreage	131
AGR-03	Reduce Deficiency Payments by Lowering Payment Limitation	132
NonDefense Discretionary Spending		133
NDD-01	Withdraw Most Federal Aid for Public Works Infrastructure	134

NDD-02 Reduce Support for Energy Supply, Conservation, and the Strategic Petroleum Reserve	138
NDD-03 Eliminate Federal Subsidies to Business	140
NDD-04 Scale Back Nondefense Construction Projects	142
NDD-05 Reduce Funding for Foreign Aid	145
NDD-06 Recover the Administrative Costs of Selected Regulatory Agencies	147
NDD-07 Charge State Member Banks and Bank Holding Companies for the Costs of Federal Reserve Supervision and Regulation	149
NDD-08 Raise Aviation User Fees to Cover Air Traffic Control Costs	152
NDD-09 Establish User Fees for Certain Coast Guard Services	154
NDD-10 Eliminate Cargo Preference for Nonmilitary Shipments	156
NDD-11 Reduce Support for Inland Waterways	158
NDD-12 Eliminate Federal Mainte- nance Assistance for Deep Draft Ports	160
NDD-13 Eliminate AMTRAK Subsidies	162
NDD-14 Reduce Federal Mass Transit Aid	164
NDD-15 Reduce and Refocus Highway Spending	166
NDD-16 Eliminate Federal Support to States for Construc- tion of Sewage Treatment Plants	168

NDD-17 Reduce Credit Subsidies to Federal Power Marketing Administrations	170
NDD-18 End the Export-Import Bank Direct Loan Program	172
NDD-19 Discontinue Postal Subsidies for Not-for-Profit Organizations	174
NDD-20 End Funding for the Legal Services Corporation	176
NDD-21 Eliminate New Lending or Increase Homeowners' Payments Under Rural Housing Loan Program	177
NDD-22 Impose a One-Year Moratorium on New Funding for the Rural Rental Assistance Program	179
NDD-23 Reduce Subsidies for Low- Income Assisted Housing	180
NDD-24 Eliminate or Restrict Eligibility for Community Development Block Grants	183
NDD-25 End Funding of the Economic Development Administration and Urban Development Action Grants	185
NDD-26 Eliminate Funding for Untargeted Elementary and Secondary Education Programs	187
NDD-27 Increase Pell Grant Targeting	189
NDD-28 Reduce Campus-Based Student Aid	191

NDD-29 Reduce Funding for the Job Training Partner- ship Act	193
NDD-30 Modify the Davis-Bacon Act by Raising the Contract Threshold and Allowing Unrestricted Use of Helpers	195
NDD-31 Convert Underused Acute- Care Beds in VA Hospitals	197
NDD-32 Require Cost Sharing for VA Hospital Care	199
NDD-33 Limit Eligibility for VA Hospital Care to Service-Disabled and Poor Veterans	201
Personnel Costs	203
PERS-01 Cap Pay Adjustments for Federal Civilian Employees	204
PERS-02 Eliminate Cost-of-Living Adjustments for Federal Retirees Under Age 62	207
PERS-03 Reduce Civil Service Retirement Benefits	209
PERS-04 Establish Supplemental Federal Retirement Benefits for New Workers	211
PERS-05 Require the Postal Service to Pay the Full Cost of Retirement and Other Benefits	213
PERS-06 Modify the Federal Employees Health Benefits Program	215
PERS-07 Reduce Federal Travel Expenses	217

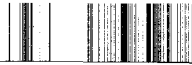




Revenues	219
REV-01 Raise Marginal Tax Rates for Individuals	221
REV-02 Amend or Repeal Indexing of Income Tax Rates	223
REV-03 Impose a Corporate Surtax	226
REV-04 Impose a Value-Added or National Sales Tax	228
REV-05 Increase Energy Taxes	232
REV-06 Increase Excise Taxes	237
REV-07 Revise Depreciation Rules	241
REV-08 Match Income with Expense for Multiperiod Construction	246
REV-09 Eliminate Investment Tax Credit or Require Full Basis Adjustment	249
REV-10 Reduce Incentives for Building Rehabilitation	251
REV-11 Repeal Percentage Depletion Allowance and Expensing of Intangible Drilling, Exploration, and Development Costs	253
REV-12 Eliminate Private-Purpose Tax-Exempt Bonds	256
REV-13 Eliminate Special Capital Gains Treatment for Timber, and for Coal and Iron Ore Royalties	260
REV-14 Eliminate Preferences for Financial Institutions	262
REV-15 Restrict Use of the Cash Method of Accounting	266
REV-16 Repeal the Dividend Exclusion	268

REV-17	Repeal the Tax Credit for Employee Stock Ownership Plans	269
REV-18	Repeal 401(k) Plans or Lower the Maximum Contribution	270
REV-19	Decrease Maximum Limits on Pension Contribu- tions and Pension Benefits	272
REV-20	Repeal Three-Year Basis Recovery Rule for Contributory Retire- ment Plans	273
REV-21	Tax a Portion of Non- Retirement Fringe Benefits	275
REV-22	Tax Cash Allowances and the Rental Value of Housing Provided to Persons in the Uniformed Services and the Clergy	279
REV-23	Restrict Deductions for Business Entertain- ment and Meals	281
REV-24	Eliminate State and Local Tax Deductibility	283
REV-25	Limit Interest Deductions	286
REV-26	Combine Miscellaneous Deductions and Employee Business Expense Deductions and Subject to a Floor of 1 Percent of AGI	288
REV-27	Increase Taxation of Non- Means-Tested Entitle- ment Benefits	290
REV-28	Eliminate Extra Tax Exemption for the Elderly and the Blind	294





REV - 29	Disallow Income Averaging for Former Students	296
REV - 30	Improve Tax Compliance and Enforcement	298
REV - 31	Reduce Tax Preferences Across the Board	300
REV - 32	Expand Minimum Taxes	302
REV - 33	Repeal the Possessions Tax Credit	306
REV - 34	Place a Per-Country Limit on the Foreign Tax Credit	307
REV - 35	Tax Capital Gains at Death	308
APPENDIX	SUMMARY TABLE OF SPENDING AND TAXATION OPTIONS BY BUDGET FUNCTION	311

TABLE I-1	BASLINE BUDGET PROJECTIONS AND UNDERLYING ECONOMIC ASSUMPTIONS ...	4
TABLE I-2	CHANGES IN CBO BASELINE DEFICIT PROJECTIONS SINCE AUGUST 1985	7
TABLE II-1.	CBO BASELINE OUTLAY PROJECTIONS FOR MAJOR SPENDING CATEGORIES	14
TABLE II-2.	BASLINE REVENUE PROJECTIONS BY SOURCE	17
TABLE II-3.	OUTLAYS AND REVENUES UNDER THE ADMINISTRATION'S 1987 BUDGETARY PROPOSALS AND AS REESTIMATED BY CBO	21
<hr/>		
BOX I-1	ON-BUDGET AND OFF-BUDGET SPENDING AND REVENUES	5
BOX I-2	MAXIMUM DEFICIT AMOUNTS AND DEFICIT REDUCTION TIMETABLE UNDER THE BALANCED BUDGET ACT	10
BOX I-3	FALLBACK DEFICIT REDUCTION PROCEDURES UNDER THE BALANCED BUDGET ACT	11
BOX II-1	FEDERAL SPENDING CATEGORIES	15
BOX II-2	WHAT DOES FREEZING THE BUDGET MEAN?	23
<hr/>		
FIGURE 1	BASLINE DEFICITS COMPARED TO TARGETS IN THE BALANCED BUDGET ACT	8
FIGURE 2	POLICY CHANGES AND RESULTING INTEREST SAVINGS REQUIRED TO MEET DEFICIT TARGETS UNDER THE BALANCED BUDGET ACT	25

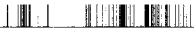




SECTION I

REDUCING THE DEFICIT





CHAPTER I

INTRODUCTION

Actions taken during the first session of the 99th Congress to restrain federal spending have appreciably improved the outlook for the budget. But unless additional steps are taken either to lower spending or to raise revenues, annual deficits are projected to remain above \$100 billion for the rest of the decade. Furthermore, the Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99-177) mandates that the deficit be reduced to levels below those that would be achieved under current policies, until a balanced budget is reached by 1991.

This volume briefly describes the outlook for the deficit and offers numerous options for helping to meet the targets laid out in the Balanced Budget Act. The remainder of this chapter presents the Congressional Budget Office's (CBO's) baseline deficit projections and describes the unique context in which budgetary decisions will be made this year. Chapter II outlines several general approaches for meeting the statutory deficit limits. The remainder of the volume presents 127 specific options for raising revenues or reducing outlays that can be used to develop alternative deficit reduction plans.

THE OUTLOOK FOR THE FEDERAL DEFICIT

Under CBO's current baseline projections, the total federal deficit is estimated to decline from \$208 billion in 1986 to \$181 billion in 1987 and to \$104 billion by 1991 (see Table I-1 and Box I-1 for projected deficits and budgetary concepts). These projections assume that the spending reduction order issued by the President on February 1, 1986, pursuant to the Balanced Budget Act, goes into effect.^{1/} That order would cancel--or"sequester"--

-
1. As described later in this chapter, the constitutionality of the automatic deficit reduction procedure that gave rise to the President's order is under challenge in court. Even if the Supreme Court eventually finds the order to be invalid, however, the Congress could effectively enact it under fallback procedures contained in the Balanced Budget Act. (See Box I-3 for a description of the fallback procedures.)

